

Internal Revenue Service  
**memorandum**

CC:TL  
Br3:BGately

date: JUL 21 1989

to: District Counsel, Brooklyn NA:BRK

from: Assistant Chief Counsel  
(Tax Litigation) CC:TL

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subject: [REDACTED]

By memorandum of July 11, 1989, your office requested Tax Litigation advice in reference to the above captioned case.

ISSUE

What is the proper method of computing the deficiency subject to additions to tax where the taxpayer previously paid an alternative minimum tax for which he is, after adjustments, no longer liable?

FACTS

Taxpayer claimed deductions on his [REDACTED] tax return for an equipment leasing activity, business expenses and interest expenses. The statutory notice of deficiency disallowed these amounts. The Tax Court held, [REDACTED], that for prior years the taxpayer was not entitled to any deductions or credits attributable to the equipment leasing activities. The Court also held the taxpayer liable for additions to tax under I.R.C. §§ 6653(a)(1), 6653(a)(2), 6659 and 6621(c). Accordingly, the taxpayer conceded the equipment leasing issues for the [REDACTED] year. Other issues not related to the equipment leasing activity were settled by compromise in Appeals, and no penalties were asserted as to these items. Taxpayer's letter to the District Counsel reflects the basis of this settlement and was filed with the Court [REDACTED].

The matter was forwarded to Appeals for computations in accord with the settlement. The taxpayer now complains that the computation as prepared by Appeals does not properly credit him with the amount of alternative minimum tax he paid. By conference call of [REDACTED], Judge [REDACTED] indicated he tentatively agreed with the taxpayer, but gave your office thirty days to seek Tax Litigation advice.

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### DISCUSSION

After due consideration, we believe the computation submitted as Respondent's Exhibit B to our Motion for Order to Show Cause Why Judgement Should Not Be Entered Against Petitioner is correct. We believe this result is best demonstrated by an examination of Temp. Reg. § 301.6621-2T, question and answer 5. <sup>1</sup>

The regulation sets forth the method whereby the amount of tax motivated underpayment is determined. This is the method which was used by [REDACTED] and, for the most part, by the taxpayer. Temp. Reg. § 301.6621-2T, A-5 provides, in pertinent part, that:

the amount of a tax motivated underpayment is determined in the following manner:

(1) Calculate the amount of the tax liability for the taxable year as if all items of income, gain, loss, deduction, or credit, had been reported properly on the income tax return of the taxpayer ("total tax liability"); and

(2) Without taking into account any adjustments to items of income, gain, loss, deduction, or credit that are attributable to tax motivated transactions (as defined in A-2 through A-4 of this section), calculate the amount of the tax liability for the taxable year as if all other items of income, gain, loss, deduction, or credit had been reported properly on the income tax return of the taxpayer ("tax liability without regard to tax motivated transactions").

(3) The difference between the total tax liability and the tax liability without regard to tax motivated transactions is the amount of the tax motivated underpayment.

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<sup>1</sup> We note that in your Motion to Show Cause Why Judgement Should Not Be Entered, this Regulation was cited, but you placed reliance on question and answer 6. We believe this was a typographical error.

A comparison of taxpayer's Exhibit B, attached to his Objection to Respondent's Motion for Order to Show Cause Why Judgement Should Not Be Entered Against Petitioner, and our Exhibit B attached to the Motion, shows clearly that the parties agree that the "total tax liability" after all adjustments is \$[REDACTED]. It is important to note that this amount was calculated taking into account not only the agreed adjustments, but also the necessary adjustment that taxpayer is not liable for the alternative minimum tax. Compare the [REDACTED] prepared 1040, styled, "Tax Return after all Adjustments", p.2, line 52, and p.7, with Petitioner's Objection, Exhibit B, item 4.

The second step, the calculation of "total tax liability without regard to tax motivated transactions", is also calculated as the same amount by both parties. This amount is \$[REDACTED]. Compare Respondent's Motion, Exhibit B, p. 4, line 5, with Petitioner's Objection, Exhibit B, item 5.

The regulation then requires that \$[REDACTED] (the total tax liability) and \$[REDACTED] (the total tax liability without regard to tax motivated transactions) be compared by subtracting the result of step two from the result of step one: \$[REDACTED] -- \$[REDACTED] = \$[REDACTED]. This amount is the "tax-motivated underpayment", \$[REDACTED]; again, both parties agree on this amount. Compare Respondent's Motion, Exhibit B, p.4, line 6, with Petitioner's Objection, Exhibit B, item 6.

The next step is required by Temp. Reg. § 301.6621-2T, Q & A-9, which states:

Q-9. What amount is subject to the 120 percent rate if the amount of a taxpayer's unpaid tax for a year is less than the taxpayer's substantial tax motivation underpayment?

A-9 The 120 percent rate applies with respect to the lesser of-

(1) The amount of unpaid tax for the taxable year determined in accordance with §301.6601-1; or

(2) The substantial tax motivated underpayment for the taxable year.

The temporary regulation requires a comparison of the unpaid tax and the tax motivated underpayment. The increased interest rate applies to whichever is less. Temp. Reg. § 301.6621-2T Q & A-9. Both parties agree that the amount of "unpaid tax" in total, is \$[REDACTED]. Compare Respondent's Motion, Exhibit B, p. 4, line 7, with Petitioner's Objection, Exhibit B, item 7. This amount corresponds to the deficiency as defined by I.R.C. § 6211, tax imposed less tax shown on return plus rebates. Here, the deficiency under section 6211 is \$[REDACTED] (tax imposed) -- \$[REDACTED] (tax per return) + [REDACTED] (rebates) = \$[REDACTED]. See also Respondent's Motion, Exhibit B, p.2.

It is important to note that the \$[REDACTED] "tax per return" which is subtracted from the tax imposed above, is derived from the \$[REDACTED] total tax as reported on the taxpayer's [REDACTED] tax return, page 2, line 56. This total includes \$[REDACTED] in income tax and \$[REDACTED] in alternative minimum tax. Therefore, the taxpayer has been given credit for the amount of alternative minimum tax previously self-assessed.

This computation is consistent with the temporary regulation's method for dealing with the situation where the unpaid tax is less than the tax motivated underpayment. Temp. Reg. § 301.6621-2T, Q & A-9. The taxpayer's alternate computation goes beyond the temporary regulation by subtracting out the alternative minimum tax a second time from the tax motivated underpayment. This duplication allows the taxpayer to reduce the amount subject to additions to tax once by subtracting the alternative minimum tax to make the unpaid tax less than the tax motivated underpayment (as allowed by the temporary regulation) and then a second time by subtracting the alternative minimum tax to lower the tax motivated underpayment below the unpaid tax. The taxpayer's subtraction of the alternative minimum tax a second time as shown in Petitioner's Objection, Exhibit B, item 7 is contrary to the structure and logic of the temporary regulation.

The lesser amount of unpaid tax, \$[REDACTED] is the amount on which the I.R.C. § 6659 amount has been calculated, and is the amount against which the § 6653 addition is calculated. The taxpayer's method is in error; it should be rejected by the Court.

CONCLUSION

We do not recommend concession of this issue. We suggest you extend the explanation set forth above to the Tax Court. If the Tax Court does not agree, ask if the issue may be briefed. Should you have any questions, Blaise Gately of this office is familiar with this matter and can be reached at FTS 566-3335.

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By:



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